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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1957

No. 384

KAL W. LINES,
Petitioner,

vs.

STATE OF CALIFORNIA, DEPARTMENT OF EMPLOYMENT,
Respondent.

PETITION FOR A WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit.

MAX H. MARGOLIS,
155 Montgomery Street,
San Francisco 4, California,
Attorney for Petitioner.

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Petitioner Kal W. Lines respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above-entitled cause March 28, 1957, timely petition for rehearing thereof having been denied July 8, 1957.

OPINIONS BELOW.

The opinion of the referee in bankruptcy (R. 4-27), printed in the Appendix hereto, pp. 1-25, is unreported.

The opinion of the District Court in reversing the order of the referee (R. 34-42), printed in the Appendix hereto, pp. 25-33, is reported in 147 F. Supp. 93.

The opinion of the Court of Appeals in affirming the judgment of the District Court (R. 46-49), printed in the Appendix hereto, pp. 34-39, is reported in 242 F. 2d 201. And the opinion of the Court of Appeals in denying the petition for rehearing (R. 54-55), printed in the Appendix hereto, pp. 41-47, is unreported.

JURISDICTION.

The judgment of the Court of Appeals sought to be reviewed was dated and entered March 28, 1957. R. 50; Appx. p. 40. The order denying the petition for rehearing was dated July 8, 1957. By order dated July 12, 1957, the mandate was stayed to and including August 19, 1957, in order to allow petitioner to prepare and file this petition with the clerk of this Court, and thereafter until such time as the petition may be granted or denied, and, if granted, until the final determination of the cause. Jurisdiction of this Court is invoked under 28 U.S.C., §1254 (1), and 11 U.S.C. §47 (c), Bankruptcy Act, §24 (c).

QUESTION PRESENTED.

Whether taxes payable by a bankrupt under the California Unemployment Insurance Act, but not paid prior to bankruptcy, may be classified as "expenses of administration" of the bankrupt estate and accorded priority in payment over wage claims.

STATUTES INVOLVED.

California Unemployment Insurance Code, §976 (Stats. 1953, c. 30, p. 1482, §976):

> "Employer contributions to the Unemployment Fund shall accrue and become payable by every employer for each calendar year with respect to wages paid for employment. The contributions are due and shall be paid to the department for the Unemployment Fund by each employer in accordance with this division and shall not be deducted in whole or in part from the wages of individuals in his employ."

11 U.S.C. §104 (a) (1) (2) (4) (Bankruptcy Act, §64 (a).):

> "(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts

in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the Bankrupt in voluntary and involuntary cases, as the court may allow: *Provided, however,* that where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants,

clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision; . . ."

11 U.S.C., §35 (a) (1) (Bankruptcy Act, § 17):

"(a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality;"

STATEMENT OF THE CASE.

Petitioner is the duly appointed, qualified, and acting trustee in the proceeding entitled "In the Matter of Roy R. Blackwood, Bankrupt." Prior to demand by the State of California for the tax imposed on employers, it was determined that the value of the estate was only sufficient to pay the expenses of administration and a 52% dividend toward the wage claims. As trustee, petitioner paid the wage dividend after first deducting state and federal taxes of the employees. When the State of California subsequently demanded that the trustee pay the employer's taxes on the wages, there were no remaining assets in the estate from which such employer's taxes could be paid. The referee in bankruptcy held that the trustee was not obligated to pay the employer taxes. (R. 4-27.) The District Court reversed. (R. 34-42.) It held that the employer's

taxes were "expenses of administration" and entitled to priority in payment over wage claims.

Although the tax involved was small, the Court of Appeals allowed an appeal pursuant to its Rule 33 (R. 44) "because of its importance to the administration of bankruptcy proceedings in the federal courts of California" (R. 46). The Court of Appeals affirmed the order of the District Court. (R. 50.) On petition for rehearing, the cause was set down for oral argument, and the Labor Commissioner of the State of California or his attorney invited to participate therein as a friend of the Court. (R. 51.) Following oral argument (R. 52), the petition for rehearing was denied, the Court of Appeals adhering to its former opinion with amendments. (R. 54-58.)

REASONS FOR GRANTING THE WRIT.

(a) THE QUESTION PRESENTED IS CLEARLY ONE OF IMPORTANCE IN THE ADMINISTRATION OF THE BANKRUPTCY LAWS.

Section 64 (a) of the Bankruptcy Act, earlier quoted, gives wages of employees earned before bankruptcy priority in payment over taxes. The decision of the Court of Appeals in this case requires a trustee in bankruptcy in California to pay the employer's tax on such earned wages of employees before the earned wages of the employees are paid. That result was reached by the Court of Appeals through characterizing the employer's tax as "expenses of administration" and shifting it from class (4) to class (1) of

said section 64 (a). The effect of the decision is to impair the order of priority in the section and to impose upon trustees in bankruptcy in California special rules of uncertainty rather than the general rules of certainty established by the section.

Section 976 of the California Unemployment Insurance Code, earlier quoted, provides that employer "contributions" to the Unemployment Fund *"shall not be deducted in whole or in part from the wages of individuals in his employ."* "Contributions" of an employer under the section are employer "taxes." (*Diamond Laundry Corp. v. California Employment etc. Co.*, 9 Cir. 1947, 162 F.2d 400 (1); *Gillum v. Johnson*, 7 Cal. 2d 744, 762-763 (14); *Cal. Employment Co. v. MacGregor*, 64 Cal. App. 2d 691, 695 (6).) The decision of the Court of Appeals in this cause requires a trustee in bankruptcy in California to pay employer taxes out of wages earned by employees before bankruptcy. This is contrary to the plain letter of said section 976 (supra).

(b) THE DECISION OF THE COURT OF APPEALS IS ONE OF FIRST IMPRESSION AND IS OBVIOUSLY ERRONEOUS, AND NOT SUPPORTED BY THE DECISIONS IT CITES.

The decision of the Court of Appeals relies upon two lines of decision. One line is concerned with situations where a trustee in bankruptcy carries on the business of the bankrupt and has employer status. (*Ingels v. Boteler*, 100 F. 2d 915, affirmed 308 U.S. 57, 521). That is not the case here, petitioner did not operate the

bankrupt's business after bankruptcy intervened. The other line is concerned with special statutes offering no parallel to said section 976 of the California Unemployment Insurance Code, prohibiting payment of employer taxes out of employee wages. (*United States v. Fogarty*, 8 Cir. 1947, 164 F. 2d 26).

The placing of respondent's tax claim in the 4th priority, (11 U.S.C. 104 (4)), where it properly belongs would at once give approval of the California law, and would not be violative of the Bankruptcy Act.

CONCLUSION.

For the foregoing reasons it is therefore respectfully submitted that a writ of certiorari should be granted.

Dated, San Francisco, California,
August 14, 1957.

MAX H. MARGOLIS,
Attorney for Petitioner.

(Appendix Follows.)

Appendix

In the Southern Division
of the United States District Court
for the Northern District of California

In Bankruptcy No. 42807

In the Matter of
Roy R. Blackwood,
Bankrupt.

FINDINGS OF FACT, OPINION, CONCLUSIONS OF LAW, ORDER, JUDGMENT AND DECREE INSTRUCTING TRUSTEE IN BANKRUPTCY IN THE ABOVE ENTITLED MATTER NOT TO COMPLY WITH THE DEMAND, OR DEMANDS, OF THE STATE OF CALIFORNIA, ACTING BY, AND THROUGH ITS DEPARTMENT OF EMPLOYMENT.

This specific controversy, in the above entitled bankruptcy proceeding, comes before the court on a petition, filed herein on May 4, 1955, by Kal W. Lines, as trustee of the bankruptcy estate of the above named bankrupt (represented herein by Max H. Margolis, Esq.) seeking instructions from the court.

In said petition it is alleged, in substance, that, on March 9, 1955, the above entitled court regularly

made and filed an "Order Settling and Allowing Receiver's and Trustee's First and Final Report and Account", after due notice to all parties interested herein, on a hearing which was held on March 8, 1955; that said order after directing said trustee to pay the administration expenses ordered to be paid by this Court, directed the balance then remaining, the sum of $955.49, to be disbursed as a first and final dividend of .5276% to the Labor Commission of the State of California, whose priority wage claim on file herein was approved and allowed, after deducting therefrom and paying to the State of California, Department of Employment, the sum of $9.55 as the employees' contribution on said wage claim dividend and to the Director of Internal Revenue, the sum of $93.25, representing Federal income taxes withheld from said dividend in the sum of $74.15 and the employees' contribution to F.I.C.A. in the sum of $19.09; that the disbursement of said sum of $955.49 was made by said trustee pursuant to the aforesaid order, leaving nothing in the hands of said trustee; that, on April 6, 1955, and on April 7, 1955, the Department of Employment of the State of California made demand upon said trustee for the payment of employer's contributions in the amount of $28.80, together with the penalty of $2.58, on the ground that said contributions were not paid on, or before, April 24, 1955, and the further demand that interest of 13¢ would be added for each month or fraction thereof, after April 30, 1955, to date of payment; that the trustee is informed and believes, and

therefore alleges, that said demand is improper for the reason that there are no further assets in the hands of said petitioning trustee and that the same is not covered by the Bankruptcy Act, as an expense of administration, being the basis upon which said Department of Employment of the State of California makes said demand.

The petition for instructions ends with the prayer, in substance, for an order of instructions denying the aforesaid demand of the Department of Employment of the State of California, or for such other, further, or different order as may be meet and proper in the premises.

From a casual examination of the petition for instructions one might be led to believe that there was an uncomplicated question to be answered herein, i.e.:

Should this bankruptcy court, under the facts and circumstances involved herein, uphold the State of California, acting by, and through, its Department of Employment, in the contention that any one of the demanded payments was, or is a part of the expenses of administration in the above entitled bankruptcy proceeding that the trustee in bankruptcy herein was and/or is bound to pay under the provisions of the Bankruptcy Act?

However, a studied consideration of each of the demands (1) of the State of California, acting as aforesaid, and relative to "employer's contributions" herein; (2) of the California law upon which any of the last mentioned demands primarily must be

based, if at all; (3) a searching exploration into all the angles presented by the record before this bankruptcy court in this bankruptcy matter, together with the belief that, so far as this branch of California law is concerned, reveals that this bankruptcy court now is called upon judicially to act in a case of first impression, and consequently makes it necessary that said bankruptcy court proceed with the greatest possible thoroughness in applying the Bankruptcy Act and the California law (as set forth in its Unemployment Insurance Code) to the unusual combination of facts and circumstances present in this particular bankruptcy proceeding.

Findings of Fact

As disclosed by the record in the above entitled bankruptcy proceeding, the facts, as this bankruptcy court finds them to be, and as they are, as follows:

1. That on June 26, 1954, E. J. Barry, Deputy Labor Commissioner of the State of California, as assignee of Florence Baker, David Funderbunk, Mary Killoran, Jessie Morrison, John H. Otis, Vince Reed, Dorothy Searcy and Alice V. Wise, filed in this proceeding, a "Proof of Priority Wage Debt" wherein, under oath, it was, and is, alleged "that Roy R. Blackwood, the person by (against) whom a petition for Adjudication of Bankruptcy has been filed, was at and before the filing of said petition, and still is, truly indebted to said deponent, in the sum of One Thousand Eight Hundred Eleven and 01/100 Dollars ($1,811.01); that the consideration of said debt is as

follows: wages earned as workmen by assignors of E. J. Barry, as shown by the attached exhibit, within three months before the commencement of proceedings herein, for which priority is claimed under Subdivision (2) of Section 64a of the United States Bankruptcy Law"; that thereafter the aforesaid priority claim was allowed, by this bankruptcy court, under the provisions of said subdivision (2) of said Section 64a of the Bankruptcy Act (11 USCA, § 104a).

2. That the State of California, acting by and through the Department of Employment, had knowledge of the above entitled bankruptcy proceeding as early as on or about May 18, 1954,* when said Department of Employment was given notice, on or about May 18, 1954, that the first meeting of creditors would be held (as it was) at Room 609 Grant Building, 1095 Market Street, San Francisco, California, at 2 P.M., on June 1, 1954.

3. That, the "Order Settling and Allowing Receiver's and Trustee's First and Final Report and Account", was signed and filed in the above entitled matter on March 9, 1955, said last mentioned order being as follows:

"The Receiver's and Trustee's first and final report and account and petition for allowances

*Although the Department of Employment is not listed as a creditor, by the herein bankrupt, and did not file any claim in the above entitled bankruptcy proceeding, it is the rule faithfully observed in the office of the undersigned referee in bankruptcy in the San Francisco jurisdiction (as it was in the above entitled bankruptcy proceeding) that all taxing authorities, including the Department of Employment, be given notice of the dates of first meetings of creditors.

of Kal W. Lines, formerly the Receiver and now the Trustee of the estate of the bankrupt above named, having come on regularly for hearing on the 8th day of March, 1955, and it appearing that ten (10) days notice of said hearing having been given to the creditors and all interested persons herein as required by law; and

"It appearing that the Receiver, having received from all of the sources set forth in his first and final report and account, the total sum of $250.00, and having made disbursements in the total sum of $14.90, and thereafter turned over the balance, namely the sum of $235.10 to himself as Trustee herein, and said Trustee, in accordance with the first and final report and account, received the total sum of $5,239.60 and disbursed, as Trustee, the sum of $3,038.11, leaving on hand a balance, as of the date of the hearing of said account, the sum of $2,201.49 and said Trustee now has in his possession the said sum of $2,201.49; and

"It further appearing that the following parties for the considerations named are entitled to the respective sums set down opposite their names in the manner following:

To C. W. Calbreath, Clerk		
Referee's salary fund	$ 52.55	
Referee's expense fund	52.55	
Referee's expense fund, mailing notices	17.40	
Referee's expense fund, 26 claims at 25¢	6.50	
		$ 129.00

To Kal W. Lines		
Receiver's commissions	$145.09	
Refund of expenses as Receiver	12.70	
Trustee's commissions	144.79	
Refund of expenses as Trustee	44.75	
		$ 347.33
To Max H. Margolis,		
Attorney for Receiver		
Ordinary compensation	$145.09	
Attorney for Trustee		
Ordinary compensation	289.58	
Extraordinary compensation	325.00	
		$ 759.67
To Gertrude S. Hayward		
Notary fees		$ 5.00
To Carolyn R. Blair		
Reporter fees		$ 5.00
On hand		$2,201.49
Total expenses of administration as aforesaid		$1,246.00
Balance		$ 955.49

and

"It further appearing that said Receiver's and Trustee's first report and account are, in all respects true and correct and no objection having been made thereto;

"It is hereby ordered that said Receiver's and Trustee's first report and account be and the same are settled and allowed *and the* respective amounts

be paid to the respective parties as hereinabove set forth; and

"It is further ordered that the remaining balance of $955.49 in the hands of the Trustee be disbursed as a first and final dividend of .5276% to the Labor Commissioner whose priority wage claim is filed and approved herein, after first deducting and paying to the State of California, Department of Employment, the sum of $9.55 as employees contribution on the above mentioned wage dividend, and to the Collector of Internal Revenue, the sum of $93.25, being Federal income tax withheld from the above stated dividend in the amount of $74.15, and employee contribution to F.I.C.A. in the amount of $19.09, said contribution being computed on the above stated dividend."

4. That, until long after the aforesaid "Order Settling and Allowing Receiver's and Trustee's First and Final Report and Account" had been signed and filed (as said order was on March 9, 1955) neither the State of California, acting as aforesaid, or otherwise, nor any representatives of said State, directly gave to this bankruptcy court, in writing, or otherwise, any intimation that the State of California, and particularly the Department of Employment thereof, was going to attempt to have the trustee of the bankruptcy estate of the above named bankrupt pay (as any expense of administration) any part of the demands referred to and mentioned, in the aforesaid petition for instructions.

5. That no petition seeking to have the aforesaid order settling and allowing said first and final report and account reviewed by a Judge of the above entitled District Court ever was filed by the State of California, acting as aforesaid, or otherwise, or by any representatives whatsoever of the State of California, or by any other party, interested, or otherwise, nor did anyone ever ask for, or receive, any extension of time within which to file a petition to review said order settling and allowing said account and report.

6. That the aforesaid, last mentioned order became a final order of the above entitled United States District Court ten (10) days after the filing of said last mentioned order, i.e., ten (10) days after March 9, 1955,* and that neither the State of California nor any

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*See, *In re Tinkoff* (C.C.A. 7) 85 F. (2d) 305, 307, wherein it is said ". . . a referee is a quasi-judicial officer who gives judgment or final order upon matters properly submitted to him, subject to review by the District Court on petition of an interested party. Adjudications of the referee, if not reviewed within the time and in the manner prescribed, have the force and effect of judgments and orders of the District Court."

See, also, *Seemann v. National Bank of Commerce of Houston* (C.C.A. 5) 112 F. (2d) 378, 380, where the Court said "In the absence of review, and within the scope of his authority as vested in him by the order of reference, his acts become binding upon the parties . . . because his orders have become the final orders of the bankruptcy court."

("A bankruptcy proceeding is a proceeding in rem, and all persons interested in the res are regarded as parties to the bankruptcy proceedings. These include the bankrupt and the trustee, as well as the creditors of the bankrupt, both secured and unsecured." *Southern Loan & Trust Co. v. Benbow* (D.C., N.C.) 96 F. 514, 528.

Consequently the State of California, as a creditor, was a party to the above entitled proceeding in bankruptcy, and was, and is, bound by said order.)

representative thereof, nor any other person, filed a petition for review, nor did anyone ask for any extension of time within which to file a petition for review.

7. That at no time subsequent to the filing of the initial petition in bankruptcy in the above entitled bankruptcy proceeding, i.e., subsequent to April 2, 1954, did the bankruptcy estate of the above named bankrupt and/or Kal W. Lines, as the receiver herein and/or as the trustee of said estate, or otherwise, or at all, on behalf of said bankruptcy estate, or otherwise, or at all, enter into any contract, agreement and/or understanding with reference to employment, written, oral, express, or implied, to employ, nor did any one of the above mentioned entities, in any capacity whatsoever, employ, on behalf of said bankruptcy estate or otherwise, or at all, any wage earner, or individual, hereinbefore referred to, and mentioned by name, or to whom anyone of said entities has paid, or did pay, out of the funds of said bankruptcy estate, any money whatsoever, directly, or indirectly, as a dividend, or otherwise, or at all, on any wages, or purported wages, of any such wage earner, or individual, except as hereinbefore specifically found.

8. That never, subsequent to the filing of the initial petition in bankruptcy herein, or otherwise, or at all, did the bankruptcy estate of the above named bankrupt, and/or Kal W. Lines, as said receiver and/or as said trustee, or otherwise, or at all, on behalf of said bankruptcy estate, make use of, have, or keep, at work,

give employment to and/or entrust with any duty, or behest, any wage earner, or individual, represented in this bankruptcy proceeding by the Labor Commissioner of the State of California, such individual being among those in whose behalf such Labor Commissioner filed the aforesaid priority claim herein and upon which said dividend was paid to such Labor Commissioner by said trustee, as a dividend, and not otherwise, and which said payment gave and/or has given rise to the controversy herein between the State of California, (acting by, and through, its Department of Employment) and said trustee, who previously had been the receiver in said bankruptcy proceeding.

9. That never, subsequent to the filing of said initial petition in bankruptcy herein, or otherwise, or at all, has said bankruptcy estate and/or Kal W. Lines, as such receiver and/or as such trustee, or otherwise, or at all, on behalf of said bankruptcy estate, or otherwise, or at all, for portion of a day, within the current calendar year, or since he became such receiver and/or such trustee, or otherwise, or at all, had any one of the hereinbefore mentioned wage earners, or individuals, in employment and/or has said bankruptcy estate and/or said Kal W. Lines, as such receiver and/or said trustee, or otherwise, or at all (on behalf of said bankruptcy estate, or otherwise, or at all) paid any wages, or dividend on any wages earned, due and/or payable to any wage earner, or individual, in the employment of said bankruptcy estate and/or has Kal W. Lines, as such receiver and/or as such trustee, or otherwise, or at all, on behalf of

said bankruptcy estate, paid, directly, or indirectly, any such wages, or dividend upon such wages, in excess of one hundred dollars ($100) or any other amount, during any calendar quarter, or otherwise, or at all.

10. That never, subsequent to the filing of the petition in bankruptcy herein, or otherwise, or at all, has said bankruptcy estate and/or Kal W. Lines, as such receiver and/or such trustee, or otherwise, or at all, on behalf of said bankruptcy estate, or otherwise, or at all, had four, or more, individuals in the employment of the herein bankruptcy estate and/or in the employment of Kal W. Lines, as such receiver and/or such trustee, or otherwise, or at all, on behalf of said bankruptcy estate, or otherwise, or at all, during the period February 1, 1945, through March 31, 1945, or during any calendar quarter subsequent thereto, or otherwise, or at all, to whom such bankruptcy estate and/or Kal W. Lines, as such receiver and/or as such trustee, or otherwise, or at all, on behalf of such bankruptcy estate, or otherwise, or at all, had paid, out of any funds of said bankruptcy estate, any wages, or dividend on any such wages, in excess of three thousand dollars ($3,000.00) or any other amount.

11. That neither said bankruptcy estate, nor Kal W. Lines, as such receiver, nor as such trustee, or otherwise, or at all, on behalf of said bankruptcy estate, or otherwise, or at all, has paid out of the funds of said bankruptcy estate, or otherwise, or at all, any money whatsoever to any wage claimant herein, but that as such trustee, Kal W. Lines, on behalf of said

bankruptcy estate, did pay the aforesaid dividend to the Labor Commissioner of the State of California, on behalf of those certain individuals who, as hereinbefore shown, were employees, and each of them was an employee of Roy R. Blackwood, prior to the commencement of the herein bankruptcy proceeding, and not otherwise.

12. That the allegations set forth in "Trustee's Petition for Instructions re Demand of Department of Employment of State of California for Payment of Employer's Contributions on Disbursement of Priority Claims and Order Setting Date for Hearing Thereof," between line 21, page 1, to, and including line 18, page 2 thereof, are true and correct.*

13. That the order of reference under which the undersigned referee in bankruptcy, under the Bankruptcy Act, heretofore has acted, and now is acting, in the above entitled bankruptcy proceeding, primarily empowered and empowers such referee in bankruptcy "to take such further proceedings therein as are required and permitted by said Act."

*Because it appears that the allegations set forth in said petition for instructions, beginning on line 19 and ending on line 25, page 2, are purely conclusions of law, no finding of fact is made thereon, this bankruptcy court reserving the right to deal with such conclusions of law later herein.

Opinion

Inasmuch as, in effect, and under the facts and circumstances prevailing herein, the State of California, acting by and through, its Department of Employment, and by, and through the Attorney General of such State and those officially assisting him, is asking the herein bankruptcy court to instruct Kal W. Lines to pay, out of his own pocket, as a part of the purported expenses of administration, the *employer's (Roy R. Blackwood's)* contribution claimed by said State, acting as aforesaid, to be involved in this bankruptcy proceeding, the State of California is bound by the rule, "Claimants seeking priorities under this Act must clearly establish their rights thereto." *In re Marshall v. Smith & Bros., Inc.* (D.C., Pa.) 35 F. Supp. 56, 57; *In re Public Ledger, Inc.* (D.C. Pa.) 63 F. Supp. 1008, 1016, and in this bankruptcy proceeding, in order to establish such rights it clearly must be shown by the State of California, acting as aforesaid, that Kal W. Lines, as receiver, or as the trustee herein, or as his individual self, on behalf of the herein bankruptcy estate, was an employer of, at least, one of the indviduals in whose behalf the aforesaid dividend was paid to the Labor Commissioner of the State of California.

Judged by the joint arguments made by Honorable Edmund G. Brown, Attorney General of the State of California, James E. Sabine, Esq., Assistant Attorney General, and Eugene B. Jacobs, Esq., in behalf of "the State of California, acting by and through the Department of Employment" (as is stated at the top of the

brief filed herein, in reply to the opening memorandum filed herein by Max H. Margolis, Esq., as attorney for the trustee), it appears that if the State of California, acting by, and through, the Department of Employment, again were called upon to say whether or not, the State, by and through, said employment department, had met herein the requirement of the rule laid down in *In re Marshall E. Smith Bros., Inc., supra,* and *In re Public Ledger, Inc., supra,* its answer would be in the affirmative, undoubtedly again directing this bankruptcy court's attention to *United States v. Fogarty* (C.C.A. 8) 164 F.(2d) 26, and *Pomper v. United States* (C.C.A. 2) 196 F.(2d) 211, for authorities for such affirmative answer.

However, it needs no painstaking effort on the part of anyone who finds it necessary to ascertain what facts and what law were before the court, in each of the last mentioned cases, to see that the facts and circumstances involved therein were not, and are not, in the least, like those in the case here under consideration, and that the laws therein instead of being a specific branch of California law, as is the basic law with which this bankruptcy court is confronted herein, were federal tax laws, whose provisions are as different from the California law involved herein as are the colors black and white.

Moreover, in neither of the last mentioned federal cases was the court therein called upon to apply the Bankruptcy Act to a set of facts and circumstances such as are before this bankruptcy court herein, and to do so where the basic California law under which

the State of California must operate, if at all, contains provisions that are not set forth in identical, or at least, somewhat similar language, in the aforesaid federal tax laws.

It is said in *Wright v. Nagle,* 101 U.S. (XI Otto) 791, 796, 797, 25 L. Ed. 921, 923, "The language of the court in the opinion is to be construed with reference to the question actually under consideration, and should not be extended beyond for any purpose of authority in another and different case."

Thus it is that the Supreme Court of the United States looks upon a case when the opinion in such a case is cited as authority in a later case, and thus it also is that, at least, one District Court of Appeal of the State of California and the California Supreme Court look upon earlier cases when cited as authorities in cases of a later date.

See *People v. Malowitz,* 133 Cal. App. 250, 255, 256, 24 P. (2d) 177, 179, wherein it is declared, ". . . by no judicial statement, however accurate and justly applicable to the case under consideration, may later cases, perhaps dependent upon altered facts or conditions, be conclusively defined, limited or determined. In other words, no general rule announced in connection with the particular facts of a given case can furnish a safe and infallible guide for the administration of justice in any other case in which the facts, conditions, or circumstances may materially differ from those present in the case in which the rule has been declared."

More briefly stated, but none the less to the same effect, is *Sharon v. Sharon,* 75 Cal. 1, 26, 16 P. 345, 356, in which it is declared, "The language of a court must always be read in view of the facts before it."

Observing this rule, as this bankruptcy court is bound to do, in the light of the facts and circumstances and the specific California law involved in the instant bankruptcy proceeding, it inescapably follows that neither *United States v. Fogarty, supra,* nor *Pomper v. United States, supra,* can be considered, or used, as a guide in determining herein whether, or not, the contentions of the State of California are of any merit, in law, so far as the problem now confronting this bankruptcy court is concerned. It therefofe appears that the only guide which this bankruptcy court has to serve it, in this matter, is, for the most part, the clear language of the California law which, if at all, gives to the State of California, by and through, the Department of Employment, the right to be heard in this bankruptcy proceeding. Looking to that law, it is to be observed that Section 601 of the California Unemployment Insurance Code states, " 'Employment', means service, including service in interstate commerce, performed for wages or under contract of hire, written, oral, express or implied," and that Section 135 of the same code declares, " 'Employment unit,' means any individual or type of organization, including any partnership, association, trust, estate, joint stock company, insurance company, corporation whether domestic or foreign, and the receiver, trustee in bankruptcy, trustee or the successor thereof, and

the legal representative of a deceased person, which has, or subsequent to January 1, 1936, had, *in its employ one or more individuals performing services for it within this State . . .*"*

"'Employer'"** states the same code, Section 675 thereof, "means any employing unit, which for some portion of a day, has within the current calendar year or had within the preceding calendar year in employment one or more individuals and pays wages for employment in excess of one hundred dollars ($100) during any calendar quarter, . . ." or, as set forth in the same code, in Section 676, "'Employer' also means any employing unit which during the period February 1, 1945, through March 31, 1945, or during any subsequent calendar quarter, pays wages for employment in excess of three thousand dollars ($3,000), and which has four or more individuals in employment on any one day during such period."

Section 976 of the California Unemployment Insurance Code further states, "Employer contributions to the Unemployment Fund shall accrue and become payable by every employer for each calendar year with respect to wages paid for employment. The contributions are due and shall be paid to the department

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*Italics added for emphasis.

**Under the Federal Tax Act, 26 USCA, §1600 et seq. . . . and particularly Section 1621(d)(1) says "The term 'employer' means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that—(1) if the person for whom the individual performs or performed services does not have control of the payment of the wages for such service, the term 'employer' . . . means the person having control of the payment of such wages . . ."

for the Unemployment Fund by each employer in accordance with this division *and shall not be deducted in whole or in part from the wages of individuals in his employ.*"***

Had the Trustee herein paid, out of the funds of this bankruptcy estate, as a part of the expenses of administration, any portion of the demand of the State of California, acting as aforesaid, he would have done so by deducting the part so paid from the otherwise payable dividend on the wages of individuals employed by the bankrupt and this he could not do without acting contrary to the plain intent of the above quoted Section (976) of the California Unemployment Insurance Code.

***Italics added for emphasis.

(It is to be noted that in the letter, signed, on behalf of the California Attorney General, by one of his deputies, appears this puzzling statement, "We would also like to make some statement concerning Section 976 of the Unemployment Insurance Code of California. It is not that section which controls in bankruptcy concerning what shall be paid as expenses of administration. Clearly in any bankruptcy matter, when there are insufficient assets to pay all wage claimants, the larger the expenses of administration, the smaller the dividend to wage claimants. Section 976 is controlling when an employer is not in bankruptcy but the rules of the Bankruptcy Act and the federal interpretation of those rules are controlling in bankruptcy."

Just what is this bankruptcy court to assume is meant by these peculiar statements? Surely they are not intended even to suggest that the Attorney General of the great State of California would have this bankruptcy court, which essentially is a court of equity (*Local Loan v. Hunt*, 292 U.S. 234, 240, 54 S. Ct. 695, 697, 78 L. Ed. 1230, 1233) violate one of the basic labor-protecting laws of California! This bankruptcy court "... whatever the consequences, we must accept the plain meaning of plain words." *United States v. Brown*, 206 U.S. 240, 244, 27 S. Ct. 620, 621, 51 L. Ed. 1046, 1047. It no more can ignore the unqualified language and crystal-clear meaning of Section 976 of the California Unemployment Insurance Code, than it can ignore the language and meanin, and the purpose of that Code.

Section 64a of the Bankruptcy Act (11 USCA, §104a), in part, provides, "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) . . . the costs and expenses of administration . . . (2) *Wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesman on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt** . . . (4) Taxes legally due and owing by the bankrupt to . . . any State or subdivision thereof . . ."

Under the facts and circumstances present herein, applying thereto, the applicable statutory enactments, both State and Federal, this bankruptcy court declares as

Conclusions of Law

(1) That neither the bankruptcy estate of the above named bankrupt, nor Kal W. Lines, as the receiver herein, nor as the trustee of the bankruptcy estate of said bankrupt, or otherwise, or at all, was an employer of any of the wage earners, or individuals, represented herein by the Labor Commissioner of the State of California, or was any of the last mentioned entities an employer of any other wage earner, or individual, so far as this bankruptcy proceeding, or the administration thereof, is concerned.

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*Italics added for emphasis.

(2) That the only employer* involved herein was Roy R. Blackwood before he filed the initial petition in bankruptcy herein upon which said initial petition he was adjudged bankrupt.

(3) That none of the wage earners, or the individuals, represented herein by said Labor Commissioner, performed any services herein for the bankruptcy estate of the above named bankrupt, or for Kal W. Lines, as receiver therein, or for Kal W. Lines, as said trustee, or otherwise, or at all, in connection with, or relative to, said bankruptcy estate and/or the administration thereof.

(4) That neither the herein bankruptcy estate, nor Kal W. Lines, as the receiver herein, nor Kal W. Lines, as such Trustee, nor otherwise, nor at all, was an employing unit in, or in connection with, or relative to, the above entitled bankruptcy proceeding and/or the administration thereof.

(5) That it would be violative of said State law, i.e., violative of Section 976 of the Unemployment Insurance Code and of the Bankruptcy Act, i.e., Section 64a (2) (USCA, §104a(2)) to pay any part of the demand, or demands, made upon the trustee herein by the State of California, acting by, and through, the

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*In connection with the "employer question" involved herein, it is interesting to note the ruling in *California Employment, etc. Commission v. Hansen*, 69 C.A. (2d) 767, 771, 772, 160 P. (2d) 173, 175, wherein it is said, "We are not unmindful of the established rule that the act herein under consideration is remedial in character and subject to liberal construction to effectuate its purpose. . . . *However the principle of liberal construction cannot be used as a pretext to create a liability against a person where none exists or appears to have been intended.* In construing a remedial statute 'reason must have its just proportion . . .'"

(The italics is that of the bankruptcy court and is for emphasis.)

Department of Employment, under the facts and circumstances disclosed by the record herein and such should be among the instructions mentioned herein.

(6) That said demands are, and each one thereof is, improper, in that said demands are, and each one of them is, not legally justified, nor is any one thereof legally justifiable under the facts and circumstances present herein and the plain language of the appropriate sections of the Unemployment Insurance Code and Section 64a of the Bankruptcy Act (11 USCA, §104a).

(7) That this Bankruptcy Court should instruct Kal W. Lines, as the trustee in bankruptcy, not only on behalf of the bankruptcy estate of the above named bankrupt, but also on behalf of himself as the former receiver herein, and on behalf of himself as the trustee herein, and on behalf of himself as an individual, not to pay any part of the demand, or demands, of the State of California, acting by, and through, the Department of Employment, or otherwise, or at all, so far as this bankruptcy proceeding and the administration thereof are concerned.

Order, Judgment and Decree

It Hereby Is Ordered, Adjudged and Decreed:

1. That the bankruptcy estate herein never was, nor did it, as such bankrupt estate, employ any of the individuals in whose behalf Kal W. Lines, as trustee of the estate of the above named bankrupt, paid a dividend to the Labor Commissioner of the State of California for, or on behalf of, the individ-

uals represented herein by said Labor Commissioner, as shown by the aforesaid priority claim.

2. That Kal W. Lines, as receiver of the herein bankruptcy proceeding, never was an employer of, nor did he, as such receiver employ any of the last referred-to individuals, either on behalf of the herein bankruptcy estate, or otherwise, or at all.

3. That Kal W. Lines, as the trustee in bankruptcy herein, never was the employer of, nor did he, as such trustee, employ any of the last referred-to individuals, either on behalf of the herein bankruptcy estate, or otherwise, or at all.

4. That Kal W. Lines, as an individual, connected with said bankruptcy estate, or otherwise, or at all, never was an employer of, nor did he, as such individual, employ any of the last referred-to individuals, either on behalf of the herein bankruptcy estate, or otherwise, or at all.

5. That none of the last referred-to individuals ever performed any service for wages, or for hire, or under, or by reason of, any contract for employment, written, or oral, or express or implied, entered into by and/or between any one, or all, of said individuals and the estate of the above named bankrupt, through Kal W. Lines, as the aforesaid receiver, or as the aforesaid trustee, or as an individual acting on behalf of said bankruptcy estate, or otherwise, or at all.

6. That, under the facts, circumstances and the California law involved in this bankruptcy proceeding, and by virtue of which the State of California by,

and through, the Department of Employment, is seeking herein to enforce, in this bankruptcy court, the demand, or demands, mentioned in the aforesaid petition for instructions, neither *United States v. Fogarty, supra,* nor *Pomper v. United States, supra,* is an authority binding upon this bankruptcy court, or upon Kal W. Lines, in any capacity and/or all the capacities hereinabove set forth and Kal W. Lines, in each and all of said capacities, so is instructed.

7. That, under the facts, circumstances and the California law involved in this bankruptcy proceeding, it would be violative of said California law, and particularly Section 976 thereof, and also violative of Section 64a of the Bankruptcy Act (11 USCA, § 104a), and particularly subsection 2 of said last mentioned section of the Bankruptcy Act, for Kal W. Lines, in any capacity and/or all of the above mentioned capacities, to comply with the demands, or any of such demands, of the State of California, acting by, and through, the Department of Employment, and Kal W. Lines, in each and all of said capacities, so is instructed.

8. That, in the light of the facts, circumstances, and California law involved in this bankruptcy proceeding, the State of California, acting by, and through, the Department of Employment, or otherwise, or at all, has not clearly, or otherwise, or at all, established the priority right sought by it, i.e., the right to be paid any employer's contribution (claimed to be involved in this bankruptcy proceeding) as an expense of administration in this bankruptcy proceeding.

9. That, under the facts, circumstances and the California law involved in this bankruptcy proceeding, and by virtue of which the State of California, acting by, and through, the Department of Employment, is seeking herein to enforce, in this bankruptcy court, the demand, or demands, mentioned in said petition for instructions, are, and each one, is not justified under any applicable law.

10. That Kal W. Lines, in each and all of the capacities hereinbefore mentioned, be, and he thus is, instructed not to pay said demands, or any one of them, either in whole, or in part, or otherwise, or at all.

Dated: September 8th, 1955.

/s/ Burton J. Wyman,
Referee in Bankruptcy.

Original—Filed Dec. 27, 1956,
Clerk, U. S. Dist. Court,
San Francisco.

(Title of court and cause omitted for brevity.)

MEMORANDUM AND ORDER

Blackwood filed a petition in bankruptcy on April 2, 1954, and was adjudged a bankrupt the same day. He was then indebted to nine employees for wages which had been earned within the three month period preceding the filing of the petition, and a claim for these wages was filed by the Labor Commissioner. Eleven months later a hearing was held and the

Referee entered his order settling and allowing the Trustee's First and Final Report. The estate was only large enough to pay the expenses of administration, and a 52% dividend toward the wage claims filed. These the trustee paid, after first deducting from the wage dividend state and federal taxes of the employees.

The State of California, acting through the Department of Employment, then demanded of the trustee that he pay the tax imposed upon employers by the California Unemployment Insurance Code. This tax is based upon wages paid to employees, and becomes payable when the wages have been actually paid.

Under § 64a of the Bankruptcy Act, (11 USCA 104), the order of priority for payment of debts is (1) expenses of administration, (2) wages, (3) certain costs incurred by creditors, and (4) taxes. The estate is insufficient to pay any 4th priority tax claims, but it is the contention of the State that their claim should be classified and paid as a 1st priority expense of administration. The Trustee petitioned the Referee for instructions and was ordered not to comply with the demands of the State and the case comes here on a Petition for Review of the Referee's Order.

There is no dispute as to the basic facts, although petitioner challenges some of the facts found by the Referee. The Court has reviewed the findings of fact made by the Referee and finds that they are supported by the record. The remaining questions are questions of law arising out of interpretations of the Bank-

ruptcy Act and the California Unemployment Insurance Code.

The Referee held that the Trustee, in paying the dividend toward the wage claims which had been filed against the estate, incurred no liability for taxes under the California statute. Section 976 of the California Unemployment Insurance Code declares that "Employer contributions to the Unemployment Fund shall accrue and become payable by every *employer* for each calendar year with respect to wages paid for employment." An *employer* is defined in § 675 as being "any employing unit, which for some portion of a day, has within the current calendar year or had within the preceding calendar year in employment one or more individuals and pays wages for employment in excess of $100 during any calendar quarter". An *employing unit* under § 135 is "any individual . . . corporation and the receiver, trustee in bankruptcy, trustee or successor thereof, which has, or subsequent to January 1, 1936, had, in its employ one or more individuals performing services for it within this state". Since the Trustee had not employed the persons to whom the wage dividend was paid, the Referee concluded that the employer's contribution did not become payable.

A similar problem was before the Court of Appeals for the Eighth Circuit in *United States v. Fogarty*, 8th Cir., 164 Fed. 2d 26, where the Trustee's liability for unemployment taxes under the Federal Social Security Act was examined. As in this case, the Trustee paid a wage dividend toward wages which had

been earned before bankruptcy and filed as a claim against the estate. The District Court, D.C. Minn., 71 F. Supp. 134, held the tax claim invalid because "the Trustee was not the 'employer' of these laborers as defined in § 1621(d) of the Internal Revenue Code . . . nor did the Trustee pay these men 'wages' as defined in § 1621(a) . . . as the laborers never rendered services to the Trustee". But the Circuit Court reversed the holding, and held that for purposes of the employment tax, the Trustee stood in the shoes of the employer-bankrupt, and the reasoning of the Court in sustaining his liability is applicable here. The Court in the Fogarty case was faced with the same obstacle that presents itself here, viz., the wording of the Social Security Act contemplated an employment relationship between the person who paid the wages and the recipient thereof. But the Court did not make its decision turn upon whether the Trustee, in paying the pre-bankruptcy wage claims, could be brought within the exact working of the statute so far as it defined "employer" and "wages". The holding was made in view of the legislative purpose underlying the Social Security Act to mitigate the hardships caused by unemployment; insofar as the benefits under the Act depended both upon the amount of wages received and the time in which they were received, holding that the payments were not wages, and that the trustee was not an employer would cause an unjustified deprivation of benefits. "But if the trustee may not be held liable for the taxes here in question, it would seem that the broad purposes

of the legislation would not be accomplished in the instances where the employer goes into bankruptcy and the wages due from him earned within ninety days of his bankruptcy are paid in whole or in part out of his assets through the bankruptcy proceedings". *(United States v. Fogarty, supra.)* These same considerations are applicable to the California Unemployment Insurance Code. The state legislation is designed to accomplish the same purpose sought by the federal Act, so far as it seeks to give relief to the unemployed. In *Gillum v. Johnson,* 7 Cal. 2d 744, the Court said:

> "The provisions of titles III and IX of the federal act make it plain that the purpose of the federal legislation was to encourage and bring about a uniform system of unemployment compensation throughout the United States. Those provisions are held out as an inducement to the states to enact unemployment compensation laws in accordance with certain general standards provided in the federal law, but leaving the actual operation of unemployment insurance and generally the numerous details in connection therewith, including the payment of benefits, to the states under their own laws."

Section 101 of the California statute states: "this part is a part of a national plan of unemployment reserves and social security, and is enacted for the purpose of assisting in the stabilization of employment conditions . . ." Because the state and federal legislation are so closely allied in purpose and provision, well-reasoned construction regarding the scope of the

federal statute should not be readily disregarded in construing the scope of the state act. The courts of California are in accord, *Union Oil v. Johnson,* 2 Cal. 2d 727, and have looked closely to federal decisions in settling problems under the State Unemployment Act. *Scripps v. Cal. Emp. Com.,* 24 Cal. 2d 669; *Cal. Emp. Com. v. Bowden,* 52 C.A. 2d (Supp.) 841.

Benefits to employees under the California Act are available only if prior employment was within the provisions of the act. (§1278, 1281) To hold that the trustee was not an "employer" here would, in some cases, deprive an employee of benefits altogether, for eligibility requires him to have earned a minimum amount of wages in his "base period" from an employer who was subject to the provisions of the act. There is, therefore, no ground here for rejection of the reasoning in the Fogarty case, or the subsequent cases adopting it. *United States v. Curtis,* 6th Cir., 178 F.2d 268; *in re Daigle,* D.C.S.D. Maine, 111 Fed. Supp. 109. This Court holds, therefore, that the Trustee in bankruptcy should be held to be an "employer", and liable for the employer's contribution upon payments made to wage claimants who have filed against the debtor estate.

Having determined that the trustee incurs liability under the California taxing statute in paying wage claims, it is necessary to decide the priority to be assigned to the tax claim, in view of the insufficiency of the estate to satisfy any claims beyond the 2nd priority wage claims.

The court in *U. S. v. Fogarty, supra,* held that the claim for federal unemployment taxes was to be treated as a first priority expense of administration. A thorough analysis of the problem leads to the conclusion that Fogarty was correct in this holding also.

The general rule is that taxes which accrue subsequent to the filing of the petition in bankruptcy are payable by the Trustee as expenses of administration. *In re Humeston,* 2nd Cir., 83 F.2d 187; *in re California Pea Products,* D.C.S.D. Cal., 37 F. Supp. 653; *In re Wil-Low Cafeterias, Inc.,* D.C.S.D. N.Y., 35 F. Supp. 965; *U. S. v. Kalloren,* 8th Cir., 119 F.2d 364; *State of Missouri v. Gleick,* 8th Cir., 135 F.2d 134; *Pomper v. U. S.,* 2nd Cir., 196 F.2d 211; *In re Garfield Fire & Clay,* D.C.W.D. Minn., 46 F. Supp. 932. The tax claims which the Trustee is directed to pay as 4th priority claims under § 64a(4) of the Bankruptcy Act are "taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof . . ." Where the tax liability has not yet accrued against the bankrupt at the time the petition in bankruptcy is filed, it is not a provable claim against the bankrupt. *Ingels v. Boteler,* 9th Cir., 100 F.2d 915, aff'd. 308 U.S. 57; *In re Berkshire Hardware Co.,* D.C. Mass., 39 F. Supp. 663; *In re California Pea Products, supra; In re International Match,* 2nd Cir., 79 F.2d 203. Unless the subsequently accruing taxes are collectible from the Trustee as expenses of administration, they are not collectible out of the bankrupt estate at all, and thus the liability of

the Trustee under the California Unemployment Insurance Code becomes meaningless.

The Referee also found that § 976 of the California Unemployment Insurance Code precluded the payment of these taxes as an expense of administration. That section says in part; "... The contributions are due and shall be paid to the department for the Unemployment Fund by each employer in accordance with this division and shall not be deducted in whole or in part from the wages of individuals in his employ." It is difficult to see the incompatibility between this provision and the holding that the employer's contribution is to be treated as an expense of administration. While the Trustee is considered to be an employer under the California Code for the purpose of payment of the employer's unemployment insurance taxes on pre-bankruptcy wages paid by the Trustee, it does not follow that the payment of the employer's taxes as an expense of administration is a deduction from the wages paid to employees. To say that the tax is being paid by deductions from the employee's wages assumes the existence of a specific fund which has been set aside for the exclusive payment of wage claims. No such fund for wage payments exists until all expenses of administration have been determined. Having determined that the California unemployment tax is an expense of administration within the provisions of the Bankruptcy Act, the Congressional mandate is that wage claims must be subordinated to expenses of administration. To apply this provision of

the California law as suggested by the Trustee would be tantamount to subordinating an expense of administration to 2nd priority wage claims. There is no need to elaborate here upon the consequence of a state statute conflicting with the order of priority of distribution set forth in the Bankruptcy Act. "Section 64 of the Bankruptcy Act provides a hard and fast categorical classification of claims against a bankrupt estate, and the order in which said claims are to be paid. This order of priorities cannot be varied or departed from. . . . Congress may determine the priority in payment to be given wages and other claims, irrespective of any state statute, and the extent to which said power is exercised becomes exclusive." *In re Penticoff*, D.C. Minn., 36 F. Supp. 1.

The order of the Referee instructing the Trustee not to comply with the demands of the State is reversed and set aside, and the matter is remanded to the Referee for further proceedings in accordance herewith.

December 26, 1956.

/s/ Oliver J. Carter
United States District Judge

United States Court of Appeals
For the Ninth Circuit

Kal W. Lines, Appellant, vs. State of California, Department of Employment, Appellee.	No. 15,484 Mar. 28, 1957

Appeal from the United States District Court
for the Northern District of California,
Southern Division

Before: Stephens, Pope and Hamley, Circuit Judges

Stephens, Circuit Judge

This is an appeal from a decision of the District Court in bankruptcy proceedings entitled "In the Matter of Roy R. Blackwood, Bankrupt." 147 F. Supp. 93. Appellant is the trustee in bankruptcy.[1]

We are here asked to determine whether a trustee in bankruptcy is required to pay to the State of California the tax imposed upon *employers* by the California Unemployment Insurance Code on wages

[1]The allowance of this appeal was granted pursuant to the provisions of Rule 33 of this Court. The amount involved is only $28.38, but the appeal was granted because of its importance to the administration of bankruptcy proceedings in the federal courts of California.

which had been earned by employees of the bankrupt within the three month period preceding the filing of the bankruptcy petition, when to do so would in effect reduce the dividend paid to the employees out of the bankrupt estate after other expenses of administration had been paid.

Prior to demand by the state for the tax imposed on *employers*, it was determined that the value of the estate was only sufficient to pay the expenses of administration and a 52% dividend toward the wage claims. The trustee paid the wage dividend after first deducting state and federal taxes of the *employees*. There were no remaining assets in the estate from which the *employer's* tax on the wages could be paid. The referee in bankruptcy held that the trustee was not obligated to pay the *employer* taxes, but this holding was reversed by the District Court in a well-reasoned opinion. *In re Blackwood*, 147 F. Supp. 93.

As was pointed out by both the referee in bankruptcy and the District Court, a trustee in bankruptcy did not come within the exact statutory definition of "employer"[2] or "employing unit,"[3] since the trustee

[2]West's Ann. Cal. Unemployment Insurance Code, §675. *Employer*. "Employer" means any employing unit, which for some portion of a day, has within the current calendar year or had within the preceding calendar year in employment one or more individuals and pays wages for employment in excess of one hundred dollars ($100) during any calendar quarter.

[3]West's Ann. Cal. Unemployment Insurance Code, §135. *Employing Unit*. "Employing unit" means any individual or type of organization, including any partnership, association, trust, estate, joint stock company, insurance company, corporation whether domestic or foreign, and the receiver, trustee in bankruptcy, trustee

had not employed the persons to whom the wage dividend was paid. But the District Court, on the basis of *United States v. Fogarty*, 8 Cir., 164 F.2d 26 and *United States v. Curtis*, 6 Cir., 178 F.2d 268, held that with respect to the wages claimed, the trustee was in effect an "employer" and liable for the *employer's* contribution based on the payments made to the wage claimants.

We agree with this holding by the District Court, but think it appropriate to further expand the reasons for reaching this result. *United States v. Fogarty*, supra, involved a claim against a trustee in bankruptcy for federal unemployment taxes as well as income with-holding taxes. As to the federal unemployment taxes, it was held that the trustee was liable for such taxes based on wages earned by the bankrupt's former employees prior to bankruptcy. It was therein pointed out that social security legislation was enacted as a broad program for the assistance of the aged and needy and that the function of the courts is to apply it in a manner to effectuate the declared purposes. It was shown that the basis for the administration of federal old age benefits is "wages" and that the *character of the payments* as wages rather than the relationship of the payor to the payee was the particular concern of the taxing provisions. The Court

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or successor thereof, and the legal representative of a deceased person, which has, or subsequent to January 1, 1936, had, in its employ one or more individuals performing services for it within this State. All individuals performing services within this State for any employing unit which maintains two or more separate establishments within this State shall be deemed to be employed by a single employing unit for all the purposes of this division.

also pointed out in *Fogarty*, supra, the federal statute failed to define employers and employees specifically. A Treasury regulation was cited which defined what the phrase "remuneration for employment" includes.

In the instant case the California Act defines "employer," and there is no state regulation or state statute which is similar to the Treasury regulation defining "remuneration for employment." But the difference is not controlling. We note that §926 of the California Unemployment Insurance Code defines "wages" as "all remuneration payable for personal services, whether by private agreement or consent or by *force of statute*, including commissions and bonuses, and the reasonable cash value of all remuneration payable in any medium other than cash." (Emphasis supplied) It is apparent that when a dividend is paid out of the bankrupt estate on a wage claim, it is being done "by force of statute." Thus the sums paid as dividends are "wage" payments within the meaning of the California Act. But we are of the opinion that even without Section 926 of the California Act defining wages, the dividend payments made would still properly be considered as wages. The mere fact that the sums were actually paid to the employees by the trustee does not deprive the payments of their primary identification as wages.

We think the following quotation in *United States v. Fogarty*, supra, at p. 29, is applicable to the instant case.

> "The fact that at the time payments were made those receiving them might no longer have been

> in the employ of the company would not be material. And certainly in many relations a trustee in bankruptcy stands in the shoes of a bankrupt and the property in his hands, unless otherwise provided in the Bankruptcy Act, is subject to all of the equities impressed upon it in the hands of the bankrupt."

The District Court was correct in holding that the reasons for enacting social security laws were practically the same for both the federal Social Security Act and the California Unemployment Insurance Code, and therefore well-reasoned construction regarding the scope of the federal act should have great weight in applying the California Code. *Gillum v. Johnson*, 7 Cal. 2d 744, 62 P.2d 1037.

We also agree with the District Court's analysis of §976 of the California Unemployment Insurance Code, which, it was argued, precluded the payment of the taxes as an expense of administration. The cited section provides in part: "* * * The contributions [employer's tax] are due and shall be paid to the department for the Unemployment Fund by each employer in accordance with this division and shall not be deducted in whole or in part from the wages of individuals in his employ." The District Court correctly determined that the California unemployment tax in the instant case was an expense of administration (it having accrued subsequent to the filing of the petition in bankruptcy) and that the payment of such tax is not a deduction from the wages paid to employees. The fund out of which the wage payments

are made does not become definite in amount until all expenses of administration have been paid. It would seem that Section 976 of the California Act was enacted to cover the usual and normal situation of a going business.

In all respects the judgment of the District Court is affirmed.

(Endorsed:) Opinion. Filed Mar. 28, 1957.
Paul P. O'Brien, Clerk.

United States Court of Appeals
for the Ninth Circuit

No. 15,484

Kal W. Lines,
Appellant,

vs.

State of California, Department of Employment,
Appellee.

JUDGMENT

Appeal from the United States District Court for the Northern District of California, Southern Division.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Northern District of California, Southern Division, and was duly submitted:

On consideration whereof, it is now here ordered and adjudged by this Court, that the Judgment of the said District Court in this cause be, and hereby is affirmed.

(Endorsed) Judgment

Filed and Entered: March 28, 1957
Paul P. O'Brien, Clerk

United States Court of Appeals
for the Ninth Circuit

Kal W. Lines, Appellant, vs. State of California, Department of Employment, Appellee.	No. 15,484 July 8, 1957

Appeal from the United States District Court
for the Northern District of California,
Southern Division.

Before: Stephens, Pope and Hamley, Circuit Judges

Stephens, Circuit Judge

On March 28, 1957, this Court rendered an opinion in this case affirming the judgment of the District Court in which it was held that a trustee in bankruptcy is required to pay to the State of California, Department of Employment, the tax imposed upon employers by the California Unemployment Insurance Code on wages which had been earned, *but not paid at the time of bankruptcy,* by employees of the bankrupt within the three month period preceding the filing of the bankruptcy petition. See *Lines v. State of California, Department of Employment,* 9 Cir., 242 F.2d 201. A petition for rehearing was filed by ap-

pellant trustee. In addition, the Labor Commissioner of the State of California filed an amicus curiae brief in support of the Trustee's petition for rehearing. We entered an order in the following words:

> "The Labor Commissioner of the State of California appears to be a California official separate and apart from the appellee, State of California, Department of Employment, and, as such commissioner, has filed a petition as a friend of the Court in support of the petition for rehearing.
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> "Inasmuch as the points raised indicate divergent views by officials of the State of California relating to the same subject matter, and inasmuch as the case was submitted to us without oral argument, we deem it appropriate to and we do now order:
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> "That the petition for a rehearing be set down for oral argument on the 11th of June, 1957, and that the Labor Commissioner or his attorney be, and hereby is, invited to participate therein as the friend of the Court."

Appellee, Department of Employment, filed a brief June 10, 1957, and the appellant Trustee filed a brief June 19, 1957, subsequent to oral argument. We now discuss the case based on the briefs, petitions and oral argument, and the opinion filed March 28, 1957, is hereby amended by adding the following.

We discuss only one point,[1] and that is whether we are correct in holding that the *employer's* tax on

[1]This point is well presented by appellee and appellant in their briefs. Points raised in the amicus brief of the Labor Commissioner we find either without merit or irrelevant to the issues upon which we granted him permission to file an amicus curiae brief.

wages, earned within the three month period preceding the filing of the bankruptcy petition *but not paid prior to bankruptcy,* is correctly held to be an expense of administration and thus entitled to first priority under §64, sub. a of the Bankruptcy Act, Title 11 U.S. C.A. §104(a).

The Trustee initially argues that our earlier opinion is inconsistent with the opinion of this Court in *Diamond Laundry Corp. v. California Employment Stabilization Commission,* C.C.A. 9, 1947, 162 F.2d 398. In that case we held that contributions of an employer under the California Unemployment Insurance Act constituted taxes.[2]

The Trustee argues that this is inconsistent with our holding in the instant case that such "taxes" are "expenses of administration." We fail to see any inconsistency. In *Diamond Laundry,* the wages had been paid. A claim can be called a "tax" and yet at the same time take on the *character* of an expense of administration due to the facts giving rise to the creation of such tax. We merely held in our earlier opinion that because the employer's tax accrued subsequent to the filing of the petition in bankruptcy, such tax had the character of an expense of administration; and thus was entitled to a first priority. In the instant case, the Trustee did not operate or run the business. The Trustee admits that if he had run the business, taxes accruing during his operation would be entitled to be classified as expenses of ad-

[2]See Vol. 2, *Remington on Bankruptcy,* §797, and Vol. 6, *Remington on Bankruptcy,* §2818.

ministration. Any inconsistency is in the Trustee's argument.

The Trustee cites *In re John Horne Company*, 7 Cir., 1955, 220 F.2d 33, as being in conflict with our decision. A reading of the *Horne* case clearly indicates the Trustee's argument to be without merit. In *Horne* the federal government unsuccessfully sought to have its claim for unemployment and withholding taxes, based on wages *paid* prior to bankruptcy, classified as a first priority. In the instant case we are dealing with taxes *not paid* before the filing of the bankruptcy petition and accruing thereafter. In *Horne*, it is stated:

> "The Trustee also conceded that the portion of the claim based on wages earned and paid subsequent to December 12, 1951 (the date of bankruptcy), and while the debtor was operating the business under Chapter XI by order and direction of the court, was entitled to priority under 64, sub. a(1), that is as an expense incurred in preservation of the estate.
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> "Thus, the issue is whether the government is entitled to have its claim for unemployment and withholding taxes, based on wages paid prior to bankruptcy, classified as a first or fourth priority under 64, sub. a, of the Bankruptcy Act. . . ."

A difference between our case and the *Horne* case is that the Trustee in the instant case did not operate the business. But we hold that this fact is not controlling. The employers' tax is not due or capable of ascertainment of amount until the wage is *paid*.

There may very well not be any wages paid out of the bankrupt estate. The amount of the wage is uncertain until the bankrupt estate is finally determined. The wages are entitled to a second priority in the instant case, but the tax involved is a tax which accrued after the bankruptcy petition was filed and thus would not be provable as a normal tax claim with fourth priority.[3] *Ingels v. Boteler*, 100 F.2d 915, affirmed 308 U.S. 57, 521; *Colman Co. v. Withoft*, 195 F. 250.

The Trustee cites *California State Board of Equalization v. Coast Radio Products*, 9 Cir., 1955, 228 F.2d 520, in which it was held that the State of California could enforce its non-dischargeable tax claim against after-acquired property of a discharged bankrupt even though the State of California failed to file a claim against the bankrupt estate when there were funds on hand sufficient to fully satisfy the tax claim. The case is inapposite. Also the taxes therein involved were due and owing at the time of bankruptcy.

As was pointed out in our earlier opinion, it was held in *United States v. Fogarty*, 8 Cir., 164 F.2d 26, 174 A.L.R. 1284, that employment and withholding

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[3] On this point the District Court in the instant case (147 F. Supp. 93, 96) cited *In re Berkshire Hardware Co.*, 39 F. Supp. 663 as standing for the proposition that where the *tax* liability has not yet accrued against the bankrupt at the time the petition in bankruptcy is filed, it is not a provable claim against the bankrupt. An examination of the *Berkshire* case shows that the case is not authority for such a proposition, but rather indicates a contrary view. But for authority in support of the District Court, see *Remington on Bankruptcy*, Vol. 2, §§797, 798, 799 and Vol. 6, *Remington on Bankruptcy*, §§2818, 2819, 2822 and 2823.

taxes which were not payable at the time the petition in bankruptcy was filed, and only accrued "as and when paid" were entitled to be classified as an expense of administration under Section 64, sub. a, of the Bankruptcy Act.[1] Like the situation in the instant case, *Fogarty* involved wages earned, *but not paid,* by the bankrupt's former employees *prior to* bankruptcy. In *Pomper v. United States*, 2 Cir., 196 F.2d 211, it was held that the federal unemployment tax is "incurred in a readily ascertainable amount as the wages are paid out," and that taxes levied on wages *paid out before* filing of a petition for arrangement under Chapter XI receive a fourth priority, while taxes levied on wages *paid out after* filing of the arrangement petition receive first priority as an expense of administration. The *Pomper* case is not limited, as urged by appellant, to a holding that the government's claim for the taxes as an expense of administration "was good only for the period the debtor remained in possession." The determining factor in *Pomper* was when the wages were *paid out* and not who was in possession. The District Court and Circuit Court in *Pomper* both spoke of "payroll tax accruing," "claims arising from payroll payments" and "payroll taxes accruing" after the filing of the petition under Chapter XI of the Bankruptcy Act.

We conclude that the District Court was correct in holding that the taxes had the character of expenses of administration. The beneficial result of insuring

[1] *In re Oceanic Ship Scaling Co., Inc.*, 100 F. Supp. 122.

that the wage earners will be credited with the employer's contributions offsets any harm that might result if the wage dividend is resultingly diminished.

The petition for rehearing is denied.

(Endorsed:) Opinion on Petition for Rehearing.

Filed July 8, 1957.

Paul P. O'Brien, Clerk.